THE REPUBLICAN SPECIAL INTEREST ECONOMIC PACKAGE

House Republicans have listened to the calls for additional tax cuts from special interest lobbyists and have produced H.R. 3090, a $160 billion package that they plan to ram through the House. This bill was carefully crafted to respond to the promises made to business lobbyists whose favorite tax breaks were left out of the $1.35 trillion tax bill earlier this year.

While Republicans call it an “economic stimulus” package to aid in the recovery from the economic downturn that began last spring and that was made worse by the terrorist attacks in September, it is really a return to business as usual. It provides a pittance to the people who need help and billions to corporate special interests over the next ten years. In 2002, nearly 90 percent of the bill is tax cuts and only 11 percent would provide benefits to unemployed workers and their families. Independent analysts find little in this package of tax cuts that will help put the economy on the road to recovery in the near term.

This package throws fiscal responsibility away. While Republicans might claim to be the protectors of the public purse, they are raiding the budget surplus with this bill. None of the cost of this bill is offset in the future when the economy will be stronger. <u>All of the $159 billion that the bill costs over ten years will come out of the Social Security and Medicare surpluses will not be repaid.</u>

This not only deepens the raids on Social Security and Medicare in the next several years, but jeopardizes the very economic recovery that we all want. Financial markets are a key factor in assuring the long-term recovery of the economy; the interest rates determined in those markets have a greater effect on business investment than prospective tax changes do. Higher interest rates that are the result of fiscal irresponsibility will depress investment and hinder economic recovery.

This package of tax cuts violates most of the principles set out by the Democratic and Republican leaders of the House and Senate Budget Committees less than two weeks ago:

- Many of the tax cuts are permanent rather than temporary.
- Few of the tax cuts will help the economy during the next 6 months.
- It fails to direct the help to “...those most vulnerable in an economic downturn...”.
- It fails to include any future offsets for the near-term cost so that the goal of paying down the greatest amount of debt can be attained.

An analysis by the Democratic staff of the House Budget Committee found that the Republican package will reduce the projected unified budget surpluses over ten years by $269 billion ($159 billion direct revenue loss plus $110 billion in debt service costs). Further, this bill by itself puts the unified budget – including Social Security – into deficit by $50 billion in 2002 and $5 billion in 2003, excluding any further defense spending associated with the aftermath of the terrorist attacks.

Democrats believe that there is a better way to encourage economic recovery. Putting most of the money quickly into the hands of people who are most likely to spend it – especially those who have become unemployed as a result of the economy – should be the top priority. Next, we need to make immediate investments in preparing to respond to future emergencies and enhancing the security of the transportation system. Finally, to restore confidence in the long-term budget outlook and maintain our commitment to preserve the Social Security surpluses once the economy has recovered, we should offset the cost of the package over ten years.

Tax Components of the Republican Package

The Republican bill consists of $99.5 billion in tax breaks in 2002 that grow to $195 billion over five years, but total $159 billion over ten years because some of the corporate breaks expire after three years. It provides $9 billion in 2002 to states to use for unemployment benefits and $3 billion to states for the Social Services Block Grant program to supplement other funds for health care coverage for unemployed workers and their families.

That is, 11 percent of the cost of the bill in 2002 is devoted to helping the unemployed and their families while 89 percent will go to tax breaks. Of the $99.5 billion in tax cuts in 2002, $70.8 billion benefits corporations, $14.8 billion benefits affluent individuals and only $13.7 billion goes to workers with lower incomes who did not get the previous rebate.

The tax cuts in the package are:

- **Repeal of Corporate Alternative Minimum Tax (AMT)** - The bill not only repeals the corporate AMT, but allows companies to receive refunds based on past AMT payments dating back to 1986 when the AMT in the current form was enacted. In 1998, only 18,360 corporations paid the AMT out of more than 4.8 million corporations filing returns. Although the corporate AMT raised only $3.3 billion in 1998, this provision costs $25.4 billion in 2002 and $24.1 billion over ten years.

- **Capital Gains rate cut** - The tax rate on income from capital gains would be reduced from 20% to 18% for taxpayers in the 25% and higher brackets and from 10% to 8% for those in the 10% and 15% brackets. Over 90 percent of this tax cut will benefit the top 10 percent of taxpayers who have incomes over $100,000. (Cost: $ 535 million in 2002 and $10.4 billion over ten years)

- **Acceleration of the reduction in the 28% rate to 25%** - This rate has already been cut to 27% and is scheduled to drop to 26% on January 1, 2004 and to 25% on January 1, 2006. This change does not benefit the 75 percent of taxpayers who are in the 15% bracket or lower. It does not take effect until January 1, 2002. (Cost: $12.8 billion in 2002; $53.7 billion over ten years)

- **Supplementary rebate** - This rebate would go to the 29 million people who filed income tax returns, but did not get the full amount of the previous rebate, or got no rebate because their tax liability (and income) was too low. This additional rebate is similar to that which many Democrats have proposed as an essential component of an economic stimulus package. (Cost: $13.7 billion in 2002 and over ten years)

- **Other individual provisions** - The bill also increases the amount of income excluded from the AMT, increases the amount of capital losses that can be deducted from ordinary income from $3,000 to $4,000 in 2001 and $5,000 in 2002, and allows tax-free withdrawals from IRAs for the purchase of health insurance by unemployed people. (Cost: $1.5 billion in 2002 and $8.2 billion over ten years)

- **Depreciation Provisions** - The bill would allow all businesses to immediately write off 30% of the cost of equipment and purchased software during the next three years rather than require amortization, increase the value of equipment purchases that can be expensed by small businesses to $35,000 from $25,000, and reduce the amortization period for leasehold improvements to 15 years. (Cost: $40.2 billion in 2002 and $25.3 billion over ten years)

- **Other Business Provisions** - The bill includes a provision that increases the carryback period over which companies can write off net operating losses (NOLs) from two years to five years. (Cost: $4.7 billion in 2002 and $452 million over ten years) It also expands and makes permanent the exception to subpart F rules that is set to expire. This provision will have no effect on economic activity in the United States because it allows multinational corporations to defer U.S. income taxes on profits from certain offshore income so long as they are kept outside of the country. The liberalization of this provision is a particular favor to insurance companies. (Cost: $260 million in 2002 and $21.3 billion over ten years).

- **Extension of expiring tax provisions and miscellaneous provisions** - The bill extends for two years eleven provisions that are set to expire at the end of 2001. These include the Work Opportunity Tax Credit, the Welfare-to-Work Tax Credit, the exclusion of the child credit and other personal credits from the individual AMT, the qualified Zone Academy Bond program, and a number of credits related to energy production and clean fuel and electric vehicles. The Democratic substitute will also extend these essential tax credits. The bill extends the Medical Savings Account program, set to expire in 2002, for one year. The bill also makes two minor technical changes affecting businesses. (Cost: $210 million in 2002 and $2.1 billion over ten years)

Spending Components

The bill provides $12 billion to states for benefits for the unemployed ($9 billion, including administrative costs) and health care coverage for the unemployed and their families ($3 billion through the Title XX Social Services Block Grant). This is similar to the administration's proposal announced earlier, in that it provides no immediate assistance to those workers who were unemployed prior to September 11 and depends on future state action instead of establishing a uniform Federal program.

Many state legislatures have adjourned for the year and will not reconvene for several months, so benefit changes under state programs would be delayed and will not be uniform across the country. Under current law and the President's proposal, only a few states would be eligible for the federally-funded extended benefits program. Therefore, CBO estimates that as little as $700 million to $2.3 billion of the $9 billion released to states will actually be used for additional or extended unemployment compensation benefits during the next twelve months.

The Thomas bill, like the administration's proposal, fails to provide enough money to address other flaws in the unemployment compensation system that keep many low-income workers from receiving benefits despite the fact that they have paid the UI tax while they were employed.

The $3 billion allocated to Title XX Social Services Block Grants to states to provide health care coverage falls far short of the need. For example, a package providing 75% of COBRA premiums and supplemental Medicaid coverage for unemployed workers has been estimated to cost $25 billion by CBO. Thus, under the Republican proposal, either fewer unemployed workers and their families would have health insurance coverage, or a much smaller share of the health insurance premiums would be paid.

Will This Package Provide Economic Stimulus?

It is difficult to see that the tax cuts and small package of spending in H.R. 3090 will provide any significant stimulus to the economy in the near term when it is most needed. In fact, it could have the opposite effect if long-term interest rates increase because the financial markets expect these tax cuts to become permanent.

Only the $13.7 billion rebate will get into the economy before the end of the year. The remaining individual tax cuts will not show up until early in 2002 and will mainly benefit higher-income people whose tendency is to save more and spend less of any tax cut. Of the permanent individual tax cuts, 88 percent benefit taxpayers with incomes over $75,000.

The capital gains rate cut in particular is not only a permanent boon to the wealthy (93 percent of it goes to the top 10 percent who have income over $108,000), but could be counterproductive if it encourages people to sell stocks to get the new rate. In fact, the Congressional Research Service concluded that "...a capital gains tax cut appears the least likely of any permanent tax cut to stimulate the economy."

Accelerating the reduction in the 28 percent rate to 25 percent benefits only the top one-fourth of taxpayers, not lower-income people who need it most and are most likely to spend it immediately. Further, it would not take effect until next January and would be implemented through lower withholding, so that the tax cut not only is delayed but it is spread out over the entire year. That will provide no stimulus within the next three months when it is most needed.

Most of the business tax cuts in the package are designed to provide an incentive for businesses to increase investment in equipment and software. However, it will have an impact that is spread out rather than concentrated in the next several months when the economy needs the greatest boost. This is primarily due to the fact that business investment has fallen because many companies have excess capacity rather than because the cost of capital is high. Therefore, the effect of even an efficient investment incentive such as partial expensing of equipment purchases is likely to be delayed until overall demand in the economy begins to show signs of picking up.

Repeal of the corporate AMT will also have little or no stimulative effect in the short-run, but could lead to an increase in corporate tax avoidance in later years.